

FX Asia Fortnightly

Emerging Market Risks Weigh

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An extra layer of complexity has been added to the current environment. The markets now not only have to deal with global trade tensions but also geopolitical tensions triggered by the sell-off in the TRY and RUB due to US trade sanctions. Should these concerns continue to feed into sentiments, we could see a further sell-off in selected AXJs including the IDR and PHP (due to their perceived vulnerability because of their twin deficits). Beneficiaries in this environment could be the USD and the JPY (due not only to some safe-haven proxy play but also due to narrowing spreads between 10Y UST and JGB yields). The USDSGD looks poised to break above key resistance around the 1.3750-levels for a move towards the 1.3780-levels, while the USDIDR and USDPHP could retake the 14500- and 53.300-levels respectively.

BI is the only central bank to meet in the next two weeks. Market is not penciling any further rate hikes for now. This is to allow the previous rate hikes to work their way into the real economy. Still, should the weakness in the IDR persist due to contagion from the sell-off in TRY, we cannot rule out a further move by the central bank.

Our in-house model implies that SGD NEER is trading 0.88% above the implied midpoint of 1.3835, suggesting it is on the stronger side of the SGD vs. other trading partner currencies.

USDJPY Could Move In Lockstep With 10Y UST-JGB Yield Spread

The USDJPY moves have not been in lockstep with 10Y UST-JGB yield differentials at all time so far this year, unlike in 2017 where the two move largely in unison. The USDJPY has moved in unison with the spread in 10Y UST and JGB in the Apr-May period and the current period starting from 26 Jul. The Apr-May period coincided broadly with rising expectations that the Fed could move more aggressively on its short-term rates given the US government's expansionary fiscal policy. The current period saw BOJ policy re-focused on 10Y JGB yields, tweaking its policy to allow more flexibility in the 10Y yield to fluctuate in a wider range. In the other two periods, the correlation between the two had broken down at the start of the year due to market speculation that the BOJ was on the verge of unwinding its massive easing monetary policy (Jan-Mar period) and escalating trade tensions between US and China had spillover effects on Japan (Jun to Jul period). With the greater flexibility for JGB yields to fluctuate and the unlikelihood of any policy reversal in BOJ policy in the foreseeable future given its forward guidance that it would hold the current low levels of interest rates for an extended period, we expect the spread between 10Y UST and JGB yields to provide directional cues for the USDJPY ahead. Technical chart suggests near term bearish bias with the 110-levels in sight.

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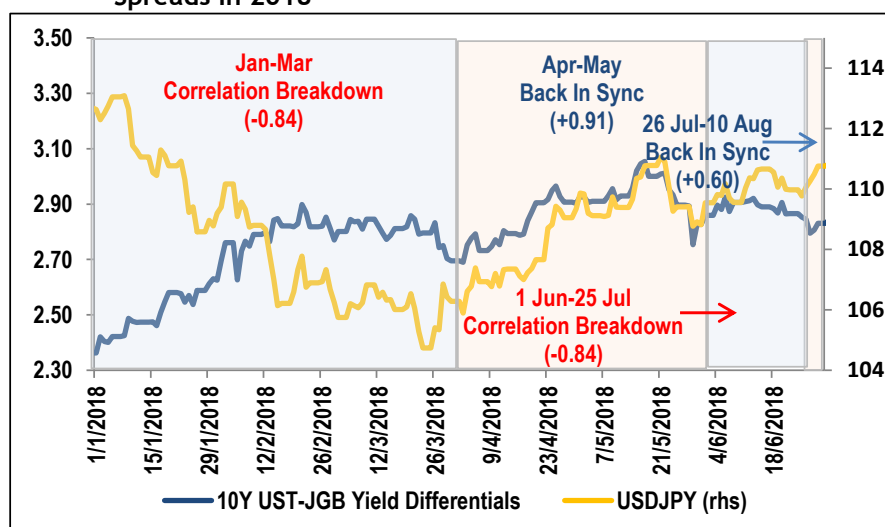
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Flavour of the Week: Revisiting USDJPY Relationship With 10Y UST-JGB Yield Differentials

- The USDJPY moves have not been in lockstep with 10Y UST-JGB yield differentials at all time so far this year, unlike in 2017 where the two move largely in unison. As Chart 1 shows, the USDJPY has moved in unison with the spread in 10Y UST and JGB only in certain periods in 2018, namely the Apr-May period and the current period starting from 26 Jul. The Apr-May period coincided broadly with rising expectations that the Fed could move more aggressively on its short-term rates given the US government's expansionary fiscal policy. The current period saw BOJ policy re-focused on 10Y JGB yields, tweaking its policy to allow more flexibility in the 10Y yield to fluctuate in a wider range.

Chart 1: USDJPY Has Not Always Been In Sync With 10Y UST-JGB yield Spreads In 2018



Note: Figures in brackets are 6-month moving average correlation coefficient

Source: Bloomberg, Maybank FX Research & Strategy

- In the other two periods, the correlation between the two had broken down at the start of the year. This was likely due to market speculation that the BOJ was on the verge of unwinding its massive easing monetary policy. This led to long JPY bets against the USD even as 10Y yield differential between the US and Japan rose. In the Jun to Jul period, escalating trade tensions between US and China had spillover effects on Japan, which was supportive of the pair even as spreads between 10Y UST and JGB narrowed.
- With the greater flexibility for JGB yields to fluctuate and the unlikelihood of any policy reversal in BOJ policy in the foreseeable future given its forward guidance that it would hold the current low levels of interest rates for an extended period, we expect the spread between 10Y UST and JGB yields to provide directional cues for the USDJPY ahead.
- The USDJPY has been on the slide for the past week, amid expectations of a major change in BOJ policy, narrowing yield differentials between 10Y UST and JGB, and emerging market risks triggered by the sell-off in the TRY and RUB. The sell-off in both the TRY and RUB had been triggered by US sanctions. Last seen around 110.97-levels. Bearish bias on the daily chart remains intact, and stochastics is falling towards oversold conditions. Further downside moves could see the pair headed

towards the 110-levels (61.8% fibo retracement of the 2018 high to low). Any rebound should meet resistance around 111.70-levels (21DMA) before 112.15-levels.

Chart 2: USDJPY Daily Chart - Near-Term Bearish Bias Intact



Key Data and Events Ahead

Currency	13-19 Aug	20-26 Aug
Japan	- Mon: - Nil - - Tue: Industrial Production, Capacity Utilization (Jun) - Wed: - Nil - - Thu: Trade (Jul) - Fri: - Nil -	- Mon: - Nil - - Tue: Machine Tool Orders (Jul F) - Wed: All Industry Activity Index (Jun) - Thu: Nikkei PMI Mfg (Aug P) - Fri: CPI (Jul)
China	- Mon: - Nil - - Tue: Retail Sales, Industrial Production, FAI Urban (Jul) - Wed: - Nil - - Thu: - Nil - - Fri: - Nil -	- Mon: - Nil - - Tue: - Nil - - Wed: - Nil - - Thu: - Nil - - Fri: - Nil -
South Korea	- Mon: - Nil - - Tue: - Nil - - Wed: Public Holiday - Thu: - Nil - - Fri: Unemployment Rate (Jul)	- Mon: - Nil - - Tue: PPI (Jul) - Wed: - Nil - - Thu: - Nil - - Fri: - Nil -
Singapore	- Mon: GDP (2Q) - Tue: - Nil - - Wed: - Nil - - Thu: - Nil - - Fri: NODX (Jul)	- Mon: - Nil - - Tue: - Nil - - Wed: Public Holiday - Thu: CPI (Jul) - Fri: Industrial Production (Jul)
Malaysia	- Mon: - Nil - - Tue: - Nil - - Wed: - Nil - - Thu: GDP, Current Account (2Q) - Fri: - Nil -	- Mon: - Nil - - Tue: Foreign Reserves (15 Aug) - Wed: Public Holiday - Thu: - Nil - - Fri: CPI (Jul)
Indonesia	- Mon: - Nil - - Tue: - Nil - - Wed: Trade (Jul), BI 7-Day Reverse Repo Rate - Thu: President's Address To The Nation - Fri: Public Holiday	- Mon: - Nil - - Tue: - Nil - - Wed: Public Holiday - Thu: - Nil - - Fri: - Nil -
Philippines	- Mon: - Nil - - Tue: - Nil - - Wed: Overseas Remittances (Jun) - Thu: - Nil - - Fri: - Nil -	- Mon: BoP Overall (Jul) - Tue: Public Holiday - Wed: Budget Balance (Jul) - Thu: - Nil - - Fri: - Nil -
Thailand	- Mon: Public Holiday - Tue: - Nil - - Wed: - Nil - - Thu: - Nil - - Fri: Foreign reserves (10 Aug)	- Mon: GDP (2Q), Customs Trade (Jul - due sometime 20-24 Aug) - Tue: - Nil - - Wed: - Nil - - Thu: - Nil - - Fri: Foreign Reserves (17 Aug)
India	- Mon: Trade (Jul - due sometime 13-15 Aug), CPI (Jul) - Tue: Wholesale Price (Jul) - Wed: Public Holiday - Thu: - Nil - - Fri: - Nil -	- Mon: - Nil - - Tue: - Nil - - Wed: Public Holiday - Thu: - Nil - - Fri: - Nil -
Vietnam	- Mon: - Nil - - Tue: - Nil - - Wed: - Nil - - Thu: - Nil - - Fri: - Nil - - Sat: - Nil -	- Mon: - Nil - - Tue: - Nil - - Wed: - Nil - - Thu: - Nil - - Fri: - Nil - - Sat: Trade, CPI, Industrial Production, Retail Sales (Aug due sometime 25-31 Aug)

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